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FEDERAL COMMUNICATIONS COMMISSION  
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In the Matter of )  
 )  
The Merger of MCI Communications ) Docket No. GN-96-245  
Corporation and British )  
Telecommunications plc )

COMMENTS OF AT&T CORP.

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## SUMMARY

BT and MCI's Application proclaims MCI's "pioneer[ing]" role in telecommunications competition in the U.S., noting that MCI "has been at the forefront of nearly every competitive initiative" in the U.S. To be sure, MCI has been among the first to challenge regulatory and market barriers in the U.S., and it has been the principal beneficiary of the regulatory and market reforms that have occurred in the U.S. over the last two decades. BT, on the other hand, continues to benefit from a market that has barriers to entry. Unlike the company it seeks to acquire, BT also continues to resist efforts to foster effective competition in its market. As a result, BT continues to have market power in the provision of all telecommunications services in the UK, including the termination of U.S. carriers' call into the UK.

In these comments, AT&T demonstrates that, unless BT's market power is constrained, the interests of U.S. consumers are likely to be impaired by the proposed merger. Specifically, BT's acquisition of control of MCI should be approved only subject to conditions that minimize the ability of BT to use improperly its market power to discriminate in favor of MCI and distort competition in the U.S. As even MCI made clear in its opposition to BT's request for non-dominant treatment in September 1996,

however, safeguards alone will not be sufficient to protect against BT's abuse of market power. Instead, effective competition must take hold in the UK.

Although there has been significant progress in the UK, there can be no dispute that the lack of carrier preselection and dialing parity (or "equal access") in the UK remains a significant barrier to effective competition. Yet, the lack of equal access in the UK not only deprives UK consumers of alternatives to BT, it deprives U.S. carriers of alternative suppliers of call termination in the UK. Further, it limits the ability of U.S. carriers attempting to self-correspond to gain the cost efficiencies BT/MCI will enjoy. Moreover, to the extent legal proportionate return rules may be relaxed on the U.S.-UK route, the lack of equal access will provide BT/MCI cost advantages that will be unable to be matched by their rivals.

For these reasons, AT&T urges that approval of BT's acquisition of MCI be made subject to competitive safeguards (including a requirement that BT establish settlement rates at its forward-looking, total service long run incremental costs) and the implementation of specific commitments by BT in the UK (including the offering of carrier preselection and dialing parity and the portability of carrier access codes for bilateral services).

In the Matter of )  
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AT&T Corp. ("AT&T"), in accordance with the Public Notice (DA No. 96-2079) of December 10, 1996, submits these comments with respect to the Application and Notification of MCI Communications Corporation ("MCI") and British Telecommunications plc ("BT") for a transfer of control of MCI to BT. BT's proposed acquisition of MCI should be made subject to competitive safeguards and the implementation of additional reforms in the UK.

In its decision approving BT's acquisition of a 20% interest in MCI,<sup>1</sup> the Commission determined that BT could leverage its dominant position in the United Kingdom ("UK") local, long distance and international services market in favor of MCI in the U.S. international and global seamless services market. To limit this potential opportunity for anticompetitive abuse by BT, the Commission imposed

<sup>1</sup> Declaratory Ruling and Order, 9 FCC Rcd 3960 (1994) ("BT/MCI I").

competitive safeguards precluding exclusive and/or discriminatory arrangements between BT and MCI and restated MCI's obligation to conform with the Commission's International Settlements Policy ("ISP") rules with respect to accounting rates and fair proportionate return.<sup>2</sup>

With BT's current proposal to acquire 100% of MCI, its incentives to discriminate in favor of MCI will increase, and changes in regulatory rules and market conditions since its initial investment will provide greater opportunities for BT to act consistent with those incentives. To be sure, BT will not be motivated to lower the above-cost settlement rates it imposes on its U.S. competitors. Further, to the extent legal proportionate return rules are relaxed on the U.S.-UK route, BT will have the opportunity and incentive to route U.S.-destined traffic disproportionately or exclusively to MCI to increase its U.S. competitors' costs. Similarly, the emergence of switched hubbing and the treatment of switched hubbed traffic in U.S. proportionate return calculations now also provide BT the opportunity to leverage its market power to favor MCI on U.S.-third country routes. Motivated by its desire to increase MCI's profitability in the U.S. while it raises MCI's rivals' costs, BT will have the incentive and

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<sup>2</sup> The Commission also accepted certain representations by the parties that they would maintain existing correspondent arrangements (id. at para. 33)-- representations that have not made in BT/MCI's Application.

opportunity to "balance off" its UK-third country traffic through MCI in the U.S., at the expense of unaffiliated U.S. carriers.

The potential for BT to discriminate in favor of MCI and to distort competition in the U.S. market will not be mitigated by relying on the evolution of competition in the UK. Although notable progress has been made in the UK, BT continues to operate without effective competition in every sector of the market and to possess market power in the provision of call termination to U.S. carriers.<sup>3</sup>

Notwithstanding the existence of international simple resale ("ISR") and the grant of international facilities based license authority to more than 40 new entrants last month, U.S. carriers still lack viable alternatives to BT for the completion of calls in the UK.<sup>4</sup> The commencement of

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<sup>3</sup> As MCI acknowledges, the amount of international traffic terminating in the UK that is carried by operators other than BT, directly or indirectly, remains insubstantial, and because there are "significant implementation issues that have yet to be decided" with respect to BT's interconnection and access obligations, "broader facilities-based competition beyond the existing duopoly is still a promise rather than a reality." Comments of MCI on BTNA Motion for Reclassification, File No. ISP-96-007-ND, p. 2, filed Sept. 6, 1996 ("MCI Comments on BTNA Motion").

<sup>4</sup> Although Mercury Communications Ltd ("MCL") is a facilities-based operator in the UK that could be an alternative for some unaffiliated U.S. carrier traffic, MCL also must rely on BT for long-haul transport within the UK. These costs limit MCL's ability to establish termination rates lower than BT's. In any event, MCL's incentive is to maintain its rates only slightly below BT's levels, as evidenced by the historical trend of accounting rates between U.S. carriers and MCL.

international facilities-based competition must await the establishment of further regulatory rules and commercial agreements with respect to cable capacity, cable station access and backhaul interconnection.<sup>5</sup> Similarly, ISR has not provided a feasible alternative for U.S. carrier completion because ISR operators are unable to offer rates competitive with the effective settlement rate (approximately \$0.036 per minute) existing carriers pay to BT under correspondent arrangements with proportionate return.<sup>6</sup> Further, the inability of ISR operators to offer viable competition to BT is compounded by the lack of equal access because it constrains new operators in their efforts to build robust businesses ultimately capable of terminating U.S. inbound calls.

Under these circumstances, appropriate safeguards, coupled with reforms in the UK, are necessary to minimize the harm to U.S. customers from BT's exercise of market power. First, the potential for price and non-price discrimination

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<sup>5</sup> Until these issues are resolved, a finding that the UK satisfies the effective competitive opportunities test for facilities-based competition would be premature. Foreign Carrier Entry Order, 11 FCC Rcd 3873 (1995).

<sup>6</sup> In 1995, AT&T delivered approximately 372.1 million minutes to BT and BT delivered 250.9 million minutes to AT&T for completion. The net settlements outpayment by AT&T to BT was approximately \$25 million. Currently, BT's settlement rate is approximately \$0.11 per minute on the imbalanced minutes delivered by AT&T. Using 1995 traffic data, AT&T's 1996 estimated unit cost of settlements (or "effective settlement rate") for all of AT&T's outbound minutes sent to BT was \$0.036 per outbound minute.



can be lessened somewhat by the continuation of the obligations imposed by the Commission on MCI in the BT/MCI I decision<sup>7</sup> and the enforcement of the Fair Trading Conditions in BT's license by Oftel in the UK. Further, because the risk of U.S. price distortion on the U.S.-UK route will be removed only by the establishment of BT settlement rates at levels based on BT's forward looking, total service long run incremental costs, BT should be required to offer such rates to unaffiliated U.S. carriers as a condition of approval. In addition, to limit the opportunity for BT to use its UK market position to distort competition on U.S.-third country routes, BT should be prohibited from routing its traffic through MCI to third countries.

As MCI made clear in its September 6, 1996 opposition to the Motion of BT North America, Inc. for reclassification as a non-dominant carrier, however, competitive safeguards alone will not be sufficient:

"Effective facilities-based competition is critical. To the extent that new entrants must use the facilities of an incumbent firm with market power to reach their customers, the incumbent can still exercise market power through its control over the price, type and quality of essential inputs for its would-be competitors.

.....

[R]egulation alone is not a substitute for actual, effective competition. As the Department of Justice

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<sup>7</sup> In September 1996, MCI argued that the "Commission should require BTNA to accept, at a minimum the same obligations and requirements that apply to MCI in connection with its relationship with BT". MCI Comments on BTNA Motion, supra note 3.

concluded -- and as MCI strongly believes based upon its own experiences -- 'Foreign regulation normally should not be considered a sufficient alternative to protect U.S. customers in the absence of any meaningful facilities-based competition, however effective that regulation may be.' [citing Reply Comments of the Department of Justice, at 17, Foreign Carrier Market Entry Proceeding; emphasis added]. ...Effective competition, not regulation, affords protection against abuse of market power.<sup>8</sup>

Most of the necessary reforms in the UK are the subject of on-going debate and appear to be on track for resolution in the near term. The lack of equal access presubscription and dialing parity is not. As shown herein, this deficiency, standing alone and irrespective of all other reforms proposed, will adversely and significantly affect competition not only in the UK, but in the U.S.

Therefore, AT&T asks the Commission to approve BT's proposed acquisition of MCI subject to:

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<sup>8</sup> Id. at 3-4. MCI also noted that "there has been no material change in any of the [relevant] factors during the last eighteen months" and

"each of the three factors on which the Commission based its finding that British Telecommunications plc (BT), BTNA's parent had market power is unchanged: BT is still the dominant carrier in a duopoly for international facilities based services; BT still controls well over 90 percent of the local termination points in the United Kingdom; and it still has the most fully developed long-distance network to which international carriers must interconnect." Id. at p.2.

- the obligations imposed in the Commission's BT/MCI I decision,<sup>9</sup> including the non-exclusivity and "no special concessions" obligations, supplemented with additional obligations to prohibit BT from routing its traffic through MCI to third countries<sup>10</sup>;
  - additional competitive safeguards requiring BT to make available to all U.S. carriers settlement rates based on BT's TSLRIC of terminating U.S. calls, and to provide one year's notice to U.S. carriers before BT routes any U.S.-destined traffic to MCI outside of traditional proportionate return rules to enable unaffiliated carriers the time required to reconfigure facilities; and
  - the implementation of carrier preselection and dialing parity, and, the portability of access codes used and promoted by U.S. carriers for correspondent services with BT, such as country direct.
- I. COMPETITIVE SAFEGUARDS ARE NECESSARY TO CONSTRAIN BT'S MARKET POWER TO LEVERAGE ITS INCREASED OPPORTUNITIES AND INCENTIVES TO DISCRIMINATE AND DISTORT COMPETITION IN THE U.S. AFTER IT ACQUIRES 100% OF MCI

Because BT continues to control over 90% of customer access lines in the UK today<sup>11</sup> and to own and operate the vast

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<sup>9</sup> The Commission also accepted representations by BT and MCI that they would maintain their existing correspondent relationships with other carriers. That representation has not been made in this case and the Commission should impose a specific obligation on BT to maintain its existing facility and services arrangements with each of its U.S. correspondents, unless and until its U.S. correspondent seeks to terminate such arrangements.

<sup>10</sup> AT&T does not object to BT routing its traffic through MCI on a consensual transit basis, whereby the traffic delivered by BT is settled at UK-third country rates and the arrangement does not affect the return of third country minutes to the U.S.

<sup>11</sup> Notwithstanding the efforts and expense unaffiliated U.S. carriers might take to reduce their dependency on BT's international or domestic long-haul network, unaffiliated U.S. carriers will be unable to avoid the use of BT's local network until effective competition takes hold in the UK local market. Virtually every call delivered to the UK by U.S.

(footnote continued on following page)

preponderance of long distance<sup>12</sup> and international facilities<sup>13</sup> and services,<sup>14</sup> unaffiliated U.S. carriers and new entrants in the UK are dependent on BT for the completion of U.S. traffic. Until effective competition takes hold in the UK, U.S. carriers will remain, either directly or indirectly (to the

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carriers is terminated via BT's local network. Alternative providers offer only direct access to business and other large customers and operate principally within and around London (e.g., Colt in the City of London) and other major urban centers. Similarly, cable television operators offer local telephone services to a small segment of residential customers.

<sup>12</sup> BT is the only vertically integrated telecom company with a nationwide network in the UK. MCL has a transport network that extends beyond urban centers, but does not terminate ubiquitously throughout the UK. BTNA's estimates that BT, based on call revenues, holds 91.7% share of the local market, 80.8% share of the national market, and 70% share of the international market in the UK. Ex Parte Presentation of BT North America, File No. ISP-96-007-ND, filed Oct. 31, 1996.

<sup>13</sup> As legal duopolists, BT and MCL own all of the existing international cable system capacity used to provide UK-U.S. and UK-world international bilateral services today. BT also controls the vast preponderance of international half-circuits between the UK and foreign points and is the only UK carrier with direct facility operating arrangements with all foreign points; the only other presently authorized competitor, MCL, provides service on a direct facility basis to approximately 80 countries. As existing owner in cable systems that land in the UK, BT and MCL also have the right to purchase additional capacity in those cables. Under the terms of cable system Construction and Maintenance Agreements ("C&MAs"), this right is generally not available to new entrants who are not owners in UK-landed cables.

<sup>14</sup> ISR providers must resell either BT or MCL's leased lines that are interconnected to BT's switched network. ISR leased lines are offered at retail rates to BT's competitors, which are higher than BT's costs of providing termination. Similarly, intra-UK competitors rely on BT for transport facilities throughout the UK, paying BT rates that are higher than BT's economic costs. Further, all UK operators are dependent on BT's local network and purchase local access from BT at rates higher than BT's economic costs.

extent they self-correspond or deliver traffic to unaffiliated operators in the UK), subject to the potential of price and non-price discrimination by BT.

Unless BT's market power is constrained, the interests of U.S. consumers are likely to be impaired by the proposed merger. As shown herein, BT's incentives to discriminate in favor of MCI and to distort competition in the U.S. will be increased as a result of its 100% acquisition of MCI, and its opportunities to act consistent with those incentives are greater since the time of BT's initial investment because of changes in market and regulatory rules. On the U.S.-UK route, BT/MCI's opportunities arise from the market power BT has over the termination of U.S. carrier calls. On U.S.-third country routes, BT/MCI's opportunities to increase their rivals' costs, while they reduce their own, stem from the traffic volumes BT continues to control as a result of its dominance in the UK. In some cases, specific competitive safeguards may mitigate the potential for anticompetitive effects in the U.S. Other potentials for abuse, however, will continue until there are changes in the UK market.

A. Continuation of the Competitive  
Safeguards Imposed in the Commission's  
BT/MCI I Decision Is Necessary to Mitigate  
the Potential for Price and Non-price  
Discrimination

The Department of Justice and the Commission both concluded that BT's 20% interest in MCI and the formation of

the BT/MCI joint venture could substantially lessen competition in the market for U.S.-UK bilateral and seamless global telecommunications services.<sup>15</sup> Specifically, the Department and the Commission found that BT could use its vertically integrated operation to discriminate in favor of MCI through the provisioning of interconnection and the international private line circuits necessary for existing and new bilateral services and global service platforms.

This discrimination could take many forms. BT, for example, could delay the provisioning of international private lines or switched transport required by its competitors, or provide inferior forms of interconnection. It could refuse to provide the arrangements needed for existing or new bilateral or global services, or it could do so on an untimely basis. In addition, as the only UK operator with facility arrangements with every foreign country, BT could use its international facilities with third countries to the exclusive benefit of MCI, or, on terms more favorable to MCI than other U.S. carriers.

BT also could steer UK-based customers to the services of MCI in the U.S. or make discounts available to local loop and other customers in the UK based on their procuring U.S.

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<sup>15</sup> Competitive Impact Statement ("CIS") filed by the Department of Justice in connection with the BT/MCI Final Judgment, Civil Action No. 94-1317, p. 14; BT/MCI I, paras. 5, 30 32, 36, 45.

services from MCI. In addition, as the Department of Justice found, BT could also provide MCI with competitively sensitive marketing and customer information or with information about BT's network on a discriminatory basis.

BT could also discriminate in its routing of U.S.-destined traffic. For example, BT could return to MCI traffic in the off-peak-hours, allowing MCI to make more efficient use of its facilities relative to other U.S. firms. BT could groom its traffic and send MCI traffic that terminates in the U.S. closer to MCI's gateway switch or where MCI has alternative, less expensive domestic access to the customer. BT could send traffic to MCI using preferred transmission medium, using less-desirable satellite facilities with MCI's competitors in the U.S.

In BT/MCI I, to address these and other potential opportunities for price and non-price forms of discrimination by BT that would distort competition in the U.S., the Commission placed specific obligations in MCI's Section 214 licenses. With BT's 100% acquisition of MCI, these safeguards must be maintained and continued. In addition, the Commission should affirmatively impose obligations to ensure that existing facility arrangements are not dismantled by BT, without the consent of the affected U.S. carrier. This requirement is necessary because the size and scope of MCI make it capable of terminating all of BT's U.S. destined

traffic, and to the extent MCI does so, BT will have the incentive and opportunity to dismantle physical facilities with unaffiliated carriers.

These competitive safeguards should be continued for so long as BT possesses market power over local interconnection, but in no event less than a period of five years from the date of the order in this case.

B. To Avoid Outbound Distortion in the U.S.-UK Market, BT Should Be Obligated to Set Settlement Rates for U.S. Carrier Traffic at Levels Based on BT's TSLRIC for Terminating U.S. Calls

Because no viable alternatives in the UK exist to carry the volume of calls sent by unaffiliated U.S. carriers, U.S. carriers remain dependent on BT for the completion of the vast majority of U.S. carrier traffic to the UK. Thus, BT possesses market power to establish above-cost settlement rates for the completion of U.S. calls in the UK.<sup>16</sup>

There is no reasonable basis to expect that BT will voluntarily agree to lower its settlement rate to cost-based levels for its U.S. competitors.<sup>17</sup> As the Commission is aware,

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<sup>16</sup> UK regulatory rules do not require BT to lower its settlement rates to cost-based levels or to offer its correspondents BT's domestic interconnection rates.

<sup>17</sup> In the Matter of BT North America Application for Authority under Section 214 to Provide International Resale Services, File No. I-T-C-93-126, 10 FCC Rcd 3204 (1995), the Commission recognized that BTNA's participation in the international simple resale market between the U.S.-UK might delay further accounting rate reductions by BT.



AT&T has had a standing offer to set rates at cost and BT has refused to do so. Indeed, BT did not adequately respond to the Commission's directive in the January 1995 BTNA Order requiring BTNA to "file...a plan setting forth significant reductions by BT...towards cost-based accounting rates with U.S. carriers over the next two years" -- ironically, a timeframe which expires this month.<sup>18</sup> Instead, BT stood firm in its position that it would reduce accounting rates according to its own schedule and based on whether U.S. traffic volumes were sufficient to compensate it in equal measure.<sup>19</sup>

BT has never disputed that its settlement rates are above-cost. At current levels (\$0.11 per minute), BT's settlement rate is approximately five times its domestic interconnection charge for the termination of domestic calls ubiquitously throughout the UK, and approximately two times AT&T's estimate of BT's forward looking, total service long run incremental costs to terminate U.S. minutes.<sup>20</sup> BT's

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<sup>18</sup> Id. at para. 10.

<sup>19</sup> Letter from J.E. Graf II, BT, to W.F. Caton, Acting Secretary, FCC, dated March 14, 1995, submitted in File No. I-T-C-93-126.

<sup>20</sup> BT has not provided evidence to determine its forward-looking, total service long run incremental costs. It is, of course, free to do so. In the absence of that information, however, the Commission should rely on the known costs of transatlantic capacity, BT's domestic interconnection charges and its tariff charges for local distribution. Based on those costs, AT&T estimates that BT's TSLRIC can be no higher than \$0.05-0.06 per minute.

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ability to maintain its settlement rates at above-cost levels while it competes in the U.S. market provides the means for BT to distort U.S. competition to benefit itself.

For so long as they remain dependent on BT for call completion, unaffiliated U.S. carriers will be required to design their prices to recoup their costs, including the artificially high settlement rates they must pay to BT. BT, however, will be able to price MCI's U.S. outbound service from the U.S. not on BT's artificially high settlement rate, but on BT's forward-looking, total service long run incremental costs to terminate MCI's minutes. That MCI may pay to BT the same nominal settlement rate (\$0.11 per minute) as unaffiliated carriers pay to BT does not change this fact because payments between MCI and BT simply will be "left pocket-to-right pocket" transfers. In the long term, BT/MCI's ability to price their outbound U.S. services at or near the effective settlement rate U.S. carriers pay will discourage entry and limit the participation of existing carriers on the U.S.-UK route.<sup>21</sup>

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<sup>21</sup> See CC Docket No. 96-149, Implementation of Non-Accounting Safeguards of Section 271 of the Communications Act of 1934, Reply Comments of the U.S. Department of Justice, August 30, 1996.

BT/MCI's ability to use BT's market power in the UK over call termination to distort competition in the U.S. is best illustrated by MCI's recent pricing action on the U.S.-UK route. On December 31, 1996, MCI revised its FCC Tariff No. 1 to establish a consumer offer for U.S.-UK calls at \$0.12 per minute. Because MCI's traffic on the U.S.-UK route is principally business customer traffic, whereas AT&T's is consumer traffic, MCI's price reduction will decrease MCI's revenues on the U.S.-UK route by \$5 million; AT&T's decision to match MCI's price will reduce AT&T's revenues by \$15 million. Importantly, BT will recoup more than \$4 million in additional settlement payments from the stimulated traffic volumes the price reductions are projected to generate. At this point, U.S. consumers benefit even though revenues will shift from U.S. competitors to BT.

To the extent proportionate return is relaxed or eliminated on the U.S.-UK route, however, BT will have the incentive and opportunity to shift revenues to it from U.S. carriers at the expense of U.S. consumers and competition. Indeed, to the extent that BT diverted all of its minutes to MCI, U.S. carriers' settlement costs paid to BT would rise correspondingly to as much as \$0.11 per minute on each and every minute delivered (a \$0.07 per minute increase from the

effective settlement rate paid today to BT).<sup>22</sup> At that level, unaffiliated U.S. carriers would be required to pay BT only \$0.01 less than the \$0.12 per minute price for U.S.-UK calls. Of course, unaffiliated U.S. carriers must also recoup other costs in their price, and they would be constrained (legally or as a matter of prudent business decision-making) in their ability to respond to the price reduction in the U.S. In the end, BT wins, while U.S. competition is damaged.

The opportunity for price distortion in the U.S. market as a result of BT's above-cost settlement rate was recognized by the Department of Justice in BT/MCI I. The Department concluded that the diversion of all or a disproportionate share of BT's traffic to MCI would harm competition among U.S. carriers by raising the settlements costs BT/MCI's rivals will pay to BT, putting unaffiliated U.S. carriers at a competitive disadvantage in the market for U.S.-UK services.<sup>23</sup> To protect against this result in the BT/MCI I transaction, both the Commission and the Department of Justice reaffirmed MCI's

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<sup>22</sup> Implicit in this discussion is that BT, after diversion of its US-destined traffic to MCI, would maintain half-circuit facility arrangements with unaffiliated carriers for the purpose of completing those carriers' U.S. outbound traffic. Absent a legal obligation to keep circuits in place to complete U.S. outbound calls, BT could instead require unaffiliated U.S. carriers to extend their networks to the UK shores by purchasing capacity from BT, at which point they could seek domestic interconnection arrangements from BT.

<sup>23</sup> Id. at 12-13.

obligation to conform with the ISP policy of fair proportionate return. The Commission's recent Flexibility Order,<sup>24</sup> however, provides for the potential relaxation of legal proportionate return rules upon a finding that the UK meets the ECO test -- the same standard by which BT's acquisition will be judged. Yet, irrespective of a finding of ECO, as defined by the Commission, the effect on competition from BT's ability to engage in outbound price distortion could adversely affect U.S. competition.

Finally, no U.S. carrier can avoid the effect of BT's price squeeze using an ISR arrangement. Despite the availability of lower domestic UK interconnection charges (\$0.02 per minute) as compared to BT's nominal settlement rate, ISR is not an option that reduces U.S. carriers' costs of termination into the UK or that otherwise checks BT's ability to engage in discriminatory conduct or outbound distortion in the U.S. market. Although BT's domestic interconnection rates to ISR operators are relatively low, when coupled with international half-channel rates available in the UK from either BT or MCL, ISR termination in the UK is higher than the effective settlement rates (\$0.036 per minute)

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<sup>24</sup> Regulation of International Accounting Rates, Fourth Report and Order, CC Docket No. 90-337, released December 3, 1996.

existing U.S. carriers pay to BT under their correspondent settlement arrangements with proportionate return.<sup>25</sup>

Moreover, no ISR operator has the capability to terminate the volumes of U.S. traffic delivered by MCI's competitors to the UK today.<sup>26</sup> To complete these significant U.S. volumes, ISR operators must make substantial investments to augment their switching capacity and backbone networks.<sup>27</sup> Yet, these investments are not feasible simply to capture U.S. traffic at rate levels sufficient to attract U.S. carriers to switch from BT (i.e., less than the \$0.036 effective settlement rate). To be viable, ISR operators (and new facilities-based operators) must capture share in the UK outbound market. But, as shown in Section II.A, the lack of equal access presubscription and dialing parity in the UK constrains the ability of new

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<sup>25</sup> To undercut the effective settlement rate, after payment of BT's domestic interconnection charge, ISR operators would have to incur costs of less than \$0.016 for all other incremental expenses -- an unlikely scenario even if ISR operators owned half-channel capacity.

<sup>26</sup> Nearly all international switched and dedicated facilities-based services between the U.S. and UK today are provided on a correspondent bilateral basis between a U.S. carrier, on the one end, and BT or MCI, on the other. In AT&T's case, approximately 67% of AT&T's U.S. outbound calls to the UK during 1995 were delivered to BT under AT&T/BT's bilateral operating agreement. MCI completed all but less than 1% of the remaining calls delivered by AT&T to the UK; the remaining less than 1% of the calls were completed by AT&T-UK.

<sup>27</sup> For example, investments in excess of \$100 million in gateway switching and backbone transport would be required to build a network capable of terminating AT&T's minutes. This amount is in addition to the costs incurred by new UK entrants to acquire UK-end cable capacity and by existing U.S. carriers to purchase new or reconfigure existing international U.S.-end half-channel capacity.

entrants to capture any meaningful share from BT and the opportunity to match the cost efficiencies of existing bilateral arrangements.

Thus, the only remedy to prevent the potential for BT to use its above-cost settlement rates to engage in outbound price distortion in the U.S. is to require BT to establish settlement rates for U.S. calls based on its forward-looking, total service LRIC of terminating U.S. calls.

C. BT Should Be Prohibited From Reoriginating its Traffic through MCI on U.S.-Third Country Routes

Opportunities for BT to use its dominant position in the UK to distort competition on U.S.-third country routes also exist. Since the BT/MCI I transaction, U.S. "reorigination" of foreign-foreign calls has become an emerging and growing market segment.<sup>28</sup> Unanticipated at the time was how reoriginated traffic would skew U.S. proportionate return (and thus the unit costs of settlements for U.S. carriers) on

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<sup>28</sup> The relaxation of third country "switched hubbing" routing rules in the 1995 Foreign Market Entry Order also provides BT/MCI a unique competitive advantage that self-corresponding U.S. carriers will be unable to match. Because BT is the only UK carrier with direct facility arrangements with all foreign points, it is uniquely situated to capture a significant share of third country traffic hubbed through the UK destined for the U.S. It is reasonable to assume that new UK entrants will face the same protracted process to obtain facility arrangements with third countries as new competitors in the U.S. have experienced. In the interim, the opportunity for BT to route the additional minutes it hubs through the UK to the U.S. over BT/MCI's U.S.-UK facilities will enable BT/MCI to realize additional cost efficiencies for on their U.S.-UK facility arrangements unmatched by other U.S.-UK competitors.

bilateral routes. Now, minutes reoriginated through the U.S. are included as part of a U.S. carrier's market share for determining the return traffic it receives from a terminating carrier. Thus, the terminating carrier allocates a greater share of return minutes to the reoriginating U.S. carrier (shifting minutes away from other U.S. competitors on the route) than the reoriginating carrier would have received based on actual U.S. customer traffic.

There is no doubt that, absent an ownership interest by the originating carrier in the hubbing carrier, foreign originating carriers are motivated to decrease their costs of routing traffic, and BT is no different in this regard. With an ownership interest in the hubbing U.S. carrier, however, reorigination is a powerful tool for a foreign carrier to benefit its U.S. affiliate to raise rivals' costs on U.S.-third country routes. In BT/MCI's case, BT can optimize the routing of its UK-third country traffic by choosing to reoriginate its traffic through MCI in the U.S. Simply put, BT has an opportunity to "balance off" its UK stream using MCI's network. Specifically, BT could send to third countries only that volume of minutes that matches the volume each third country sends to it -- leaving BT with no settlements outpayment. The additional minutes generated by BT's customers above the balance could then be delivered through MCI's network in the U.S. -- earning MCI a greater share of



return minutes at the expense of its competitors on third country routes. As MCI realizes lower costs of settlement on the third country routes as compared to unaffiliated U.S. carriers whose costs will rise correspondingly, MCI's U.S. rivals will be unable to compete effectively on the third country route. To protect against this potential injury to competition, BT should be prohibited from routing foreign-originated minutes through MCI in the U.S. to third countries.

II. COMPETITIVE SAFEGUARDS MUST BE SUPPLEMENTED BY CHANGES IN THE UK MARKET TO LIMIT THE POTENTIAL OF BT TO REDUCE COMPETITION IN THE U.S.

In its BT/MCI I Competitive Impact Statement, the Department of Justice concluded that BT's continued dominance in the UK market is attributable to a number of factors, including BT's control of the local network and the largest and most comprehensive long distance and international telecommunications network in the UK. In addition, the Department specifically cited the lack of equal access presubscription and dialing parity for BT's competitors, the lack of number portability and the access deficit regime which imposed subsidies (in addition to BT's interconnection prices) on BT's competitors. Since 1993, many positive changes have been made in the UK market, including the elimination of